

Swet Ganga Hydropower & Construction Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Long Term Bank Facilities	5,268.00 (Increased from Rs. 4,779 Mn)	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank facilities	120.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	5,388.00 (Five Thousand Three Hundred and Eighty- Eight Million Only)		
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Reaffirmed

**The issuer rating is subjected to the company maintaining overall gearing not exceeding 3.50x at the end of FY23 (FY refers to the twelve-month period ending mid-July).*

***Details of instruments / facilities in Annexure-1*

CARE Ratings Nepal Limited (CRNL) has reaffirmed Issuer rating of 'CARE-NP BB (Is)' assigned to Swet Ganga Hydropower & Construction Limited (SGHCL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations in Nepal.

Also, CRNL has reaffirmed the rating of 'CARE-NP BB' for the long-term bank facilities and 'CARE-NP A4' for the short-term bank facilities of SGHCL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to SGHCL are constrained by the relatively high cost of project leading to leveraged capital structure and relatively higher financial burden on the company in the initial years of operations. In addition, the ratings remain constrained by hydrology risk associated with run-of-the-river power generation, risk of natural calamities, exposure to volatile interest rate risk and regulatory risk.

The ratings, however, derive strength from strong parentage and experienced management team and presence of power purchase agreement (PPA) with sufficient period coverage. The ratings also factor in moderate counter party risk and government support for power sector. The ratings also take cognizance of SGHCL's moderate operational performance in the early years of operations, sustenance of which remains imperative from credit perspective in coming years.

Going forward, the ability the company to successfully reduce the gap between operational PLF and contracted PLF and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Leveraged Capital Structure

SGHCL's overall gearing ratio stood high at 3.41x at the end of 9MFY23 (Unaudited, refers to the nine-month period ending mid-April) owing to the relatively high project cost of Rs. 6,861 Mn (Rs 244 Mn per MW) which was financed through Debt equity mix of 77: 23. The cost was revised from initially estimated Rs. 5,591 Mn mainly on account of the modification of civil works and extra works requirement related to tunnel excavation works, elevated cost due to escalation clauses in contract and increase in Interest During Construction (IDC) and management/ administrative expenses due to time over-run. Owing to higher debt levels, debt coverage indicators expected to remain weak in the initial year of operations. Interest coverage ratio was also modest at 1.14x in 9MFY23. The incurred project cost of Rs. 244 Mn per MW is considered relatively higher; thus, the payback period of the company is expected to remain longer. The ability of the company to improve its net profitability with better debt service coverage indicators thereby lowering its gearing levels is critical from credit perspective.

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river power is considered an unsteady source of power, as a run-of-the-river project has little or no capacity for water storage and therefore is dependent on the flow of river water for power generation. It, thus, generates much more power during summer season when river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-Dec to Mid-April). SGHCL is proposed to utilize discharge from Likhu Khola having catchment area of 755 sq. kms based on snow-fed river. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

Risk of Natural Calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their operations vulnerable to adversities of nature. Floods and landslides that tend to occur in these areas pose threat to these power projects damaging their infrastructures. These natural calamities can adversely affect the smooth flow of power generation and distribution, which can impact financial returns of the projects. SGHCL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Exposure to volatile interest rate risk

The company's interest rates are based on a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed to volatile interest rate.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) for regulating hydropower companies in Nepal. ERC will regulate generation, transmission and distribution of electricity in Nepal among others. Policies and directives issued by ERC such as approval process for IPO issuance and PPA approval through ERC poses a new challenge to hydropower companies. Hence, the hydropower sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strength**Board members and management having experience in hydro power sector**

SGHCL is currently managed by Mr. Anup Kumar Upadhyay (Chairman), has more than two decades of experience and served in different department and ministries of GoN under different designation, roles and responsibilities. Dr. Subarna Das Shrestha, Executive Director, has an overall experience of around two and half decades in power generation sector especially hydro projects though his association with various companies. He was past President of Independent Power Producers Association of Nepal (IPPAN). The company management team is led by Bhoj Raj Poudel, General Manager of the company and has more than ~29 years of experience. He has been supported by other experienced management team members.

Strong institutional promoter group

SGHCL is part of Sanima Hydro Group which is promoted by group of Non-Resident Nepalese who are related to Sanima Group of Companies, having business interest in Hydropower, Banking and Insurance sector. The group has been developing hydropower projects by setting up Special Purpose Vehicle (SPV) companies in Nepal. Dolma Impact Fund (DIF) which has invested Rs. 385.85 Mn equity (holds 24.22% as on Mid-April, 2023) in SGHCL is an institutional investor and is the first commercial impact fund setup in Nepal for providing growth capital to Small and Medium Enterprises (SMEs) with strong entrepreneurial and management capacities.

Moderate operational performance

SGHCL started commercial operation in November 2022. The plant was operational for 5.5 months at 37.97% of its generation capacity. The total energy generated against the contracted PLF during the period was 77.95%. The energy generation was slightly affected in Mid-Oct to Mid-Dec due to dispatch instructions from NEA on account of some issues in transformer at NEA Khimti Substation, which has been solved therefore there has been no issues in power evacuation since Mid-December. The average PLF as % of contracted energy was 87% for 4 months period (Mid- December to Mid-April). Ability of the company to sustain its operational Plant Load Factor (PLF) close to the contracted levels is critical from revenue generation perspective and will remain a key monitorable aspect.

Power purchase agreement with sufficient period coverage

SGHCL had entered into a long term PPA with NEA as on December 29, 2016 for sale of 28.10 MW power to be generated from the project. The contracted energy for 28.10 MW is 170.84 Million Units (MU) annually with the contracted Plant Load Factor (PLF) of 69.40%. PPA has been entered for the period of 30 years from the COD or till validity of generation license whichever is earlier. Tariff rate as per is Rs 4.80 per kWh for wet season (Mid-April to Mid-December) and Rs 8.40 per kWh for dry season (Mid-December to Mid-April) with 3% annual escalation on base tariff for 8 years. SGHCL came into commercial operation on November 05, 2022 as against the Required Commercial Operation Date (RCOD) of October 27, 2022, hence the company is eligible for escalation for entire 8 years.

Favorable Government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years for such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2027. Also, with government focus more towards reservoir-based hydropower projects; Monetary Policy FY23 has provided full tax exemption for first 15 years and 50% tax exemption for next 6 years to reservoir and semi- reservoir projects whose capacity is higher than 40 MW, completing financial closure within mid-April 2029. As per various directives from NRB, all the banks (type A, B C, D) have to allocate minimum share of their total advances to energy sector which argues well for the sector. Also, increasing trend of cross-border energy trade and its prospect in upcoming days with bilateral agreements with the neighboring nations shows positive outlook on long- term demand for the power sector.

About the Company

Swet Ganga Hydropower & Construction Limited (SGHCL) is a Public Limited company, incorporated as on February 28, 2005 as Swet Ganga Hydropower & Construction Private Limited and later changed to Public limited on October 03, 2016. It is promoted by individual promoters from different background, institutional investors majorly related to Sanima Hydro group and other institutes which includes Banks and Investment companies for operation of a 28.1 MW run-of-river, Lower Likhu Hydropower Project (LLHP) located in Ramechhap district of Nepal. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Brief financial performance of SGHCL during 9MFY23 is given below:

(Rs. In Million)

Particulars	9MFY23 (UA)
Income from operations	296
PBILDT Margin (%)	236
Overall Gearing (times)	3.41
Interest Coverage (times)	1.14
Total Debt/ Gross Cash Accruals (times)	113.91

UA: Unaudited

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	5,268.00	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	120.00	CARE-NP A4
Total Facilities		5,388.00	

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